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## NEW STRAINS IN JAPAN-SOUTH KOREA ECONOMIC RELATIONS

## SUMMARY

*South Korea's extraordinary economic advances during the last three decades or so have been described as following a flying-geese pattern of development. Learning from Japanese experiences during the postwar economic reconstruction period, the government in Seoul adopted policies promoting specific export-oriented industries. Recently, however, the South Korean economy has begun to lose the advantages of being a latecomer. National income is approaching the level achieved by industrial economies. Moreover, the rapid rise in the wages of South Korean workers has eroded the low-cost advantage key to international competitiveness in labor-intensive industries.*

*A triangular relationship with the United States, both as a buyer and a supplier, and Japan, primarily as a provider of capital goods and technology, has facilitated South Korea's economic catch-up. South Korea's economic growth, however, not only has altered internal expectations — for higher wages and salaries, for example — but similarly has resulted in revised external expectations. Washington, pressed by American manufacturers affected by competition from South Korean products, no longer views South Korea as a developing economy and has urged Seoul to liberalize domestic markets and protect intellectual property rights more effectively. Tokyo, for its part, has experienced the changes in the South Korean economy from a perspective different from Washington's, at times finding itself the target of complaints over Japanese trade practices and at other times leveling charges of unfair trade practices against Seoul.*

*Economic talks between Tokyo and Seoul have focused on enlarging South Korea's exports to Japan and facilitating transfers of Japanese industrial technologies. But trade is not the only stumbling block to improved bilateral relations. To some extent a gap exists between Japanese and Korean views of one another — the outgrowth of a complicated, long-term Tokyo-Seoul political relationship and ethnic rivalry between the two nations.*

## South Korean Economic Development

South Korea's economic expansion has been so extraordinarily rapid over the past three decades that the country has been named one of East Asia's Four Tigers along with Hong Kong, Singapore and Taiwan. Except for the period between 1977 and 1981 real economic growth averaged between 7.8 percent and 10 percent annually, a pace that exceeded the targets projected in Seoul's five-year economic plans (see Table 1). In 1991 South Korea had a per capita gross national product of \$6,300; by 1996, when the current five-year plan ends, the government expects the country's GNP per person to exceed \$10,000. The 1992-96 plan envisions the economy increasing at what for South Korea is the relatively moderate inflation-adjusted rate of 7.5 percent a year. Growth on that order, however, is far faster than that anticipated for developed economies. The economies of the 24 member countries of the Organization for Economic Cooperation and Development are projected to expand by an average 1.8 percent in real terms this year and by 3 percent in 1993. Japan's recently released FY 1992-FY 1996 economic plan puts real GNP growth slightly higher than the OECD average at 3.5 percent a year. Some analysts have the same doubts about South Korea's ability to achieve its growth target as they do about Japan, but South Korea's advances to date have led many observers to expect the OECD to admit that country as a member before the end of this century.

Table 1: Growth Target and Performance under South Korea's Five-Year Economic Plans

| <u>Plan</u> | <u>Period</u> | <u>Planned<br/>Real<br/>GNP<br/>Growth</u> | <u>Actual<br/>Real<br/>GNP<br/>Growth</u> |
|-------------|---------------|--------------------------------------------|-------------------------------------------|
| First       | 1962-1966     | 7.1%                                       | 7.8%                                      |
| Second      | 1967-1971     | 7.0                                        | 9.6                                       |
| Third       | 1972-1976     | 8.6                                        | 9.7                                       |
| Fourth      | 1977-1981     | 9.2                                        | 5.8                                       |
| Fifth       | 1982-1986     | 7.5                                        | 8.6                                       |
| Sixth       | 1987-1991     | 8.2                                        | 10.0                                      |
| Seventh     | 1992-1996     | 7.5                                        | n.a.                                      |

Source: Republic of Korea, Economic Planning Board

South Korea's economic success has been attributed in part to the fact that Japan's postwar economic reconstruction provided a development model for Seoul. Despite differences between the island nation and the peninsular nation, the two East Asian countries share a similar cultural heritage and economic environment. Both, for example, are densely populated and poor in natural resources. A deep respect for education has contributed to the emergence of a well-educated work force. The need to import industrial and agricultural inputs, combined with their human-resources endowments, led to the development of export-oriented industries in both countries. Like Japan's Ministry of International Trade and Industry, South Korea's Ministry of Trade and Industry has implemented policies to foster specific industrial sectors. In historical order these have included textiles, shipbuilding, steel, motor vehicles and electronics. Domestic entrepreneurs organized *keiretsu*-type conglomerates, such as Samsung, Hyundai and Goldstar, that have benefited from the government's industrial promotion initiatives. The Korea Development Bank and the Export-Import Bank of Korea have provided financial assistance to targeted industries, much as Japan's government-owned banks

did. The Korea Trade Association, like the government-affiliated Japan External Trade Organization, has helped the business community improve sales in overseas markets. Since South Koreans and Japanese share common Confucian values, the Korean people had little difficulty in following the Japanese pattern of capitalism, in which the government plays a leading role in guiding the private sector's activities. In fact, the linkage between the government and the private sector in South Korea has been even stronger than has been the case in Japan.

The United States and Japan, the two leading economies in the Pacific region, facilitated South Korea's economic development. Apart from providing military security through the stationing of U.S. forces in South Korea, Washington gave relatively substantial amounts of foreign aid to Seoul until the mid-1980s. Moreover, American firms invested money in South Korea and transferred technology to that country, while the U.S. market absorbed a significant part of South Korea's expanding output of manufactured goods.

For its part Tokyo provided \$504 million in grants and nearly \$2.6 billion in yen loans on concessional terms to Seoul between 1965 and 1990, initially as compensation for Japan's colonization of the Korean peninsula between 1910 and 1945. Although by 1984 South Korea's per capita GNP had reached \$2,000 — regarded as the upper limit of eligibility for concessional yen loans, Tokyo lent Seoul \$1.85 billion between 1983 and 1990 in line with an agreement reached in January 1983 between then Prime Minister Yasuhiro Nakasone and then President Chun Doo Hwan. During the 1983-91 time frame Japanese companies hosted more than 1,000 South Korean technicians under a government-sponsored special training program also initiated by Messrs. Nakasone and Chun. Together with the financing and the technical cooperation extended by Japan's private sector, this assistance further helped to accelerate South Korea's economic development.

Hard work, the benefits of latecomer status, outside assistance and an effective industrial policy have brought South Korea's economy close to the level of a developed economy. In 1990 South Korean companies invested more overseas than foreign firms put into South Korea. In another sign of the country's new economic status Seoul established the Economic Developing Fund in 1987 and the Korea International Cooperation Agency in 1990 to provide financial and technical assistance to developing countries. The 1988 Summer Olympic Games impressed both a worldwide television audience and those attending in Seoul that South Korea no longer was a developing nation, Korean observers point out.

### **Economic Policy Pressures**

When South Korea's standard of living was relatively low government officials felt they could ask citizens to be patient until the nation's economic pie grew large enough to share the benefits. Rapid economic growth, however, resulted in increasing demands for the immediate betterment of people's lives as well as sweeping political reform. The dramatic democratization initiatives unveiled by President Roh Tae Woo before he assumed office in February 1988 gave momentum to the labor movement's push for better living conditions through higher wages. Helped by the labor shortages caused by the construction boom before the 1988 Seoul Olympics, this campaign succeeded. Between 1985 and 1990 the average South Korean worker's wages soared 2.19 times.

Not surprisingly, productivity gains in the manufacturing sector did not keep pace with the jump in pay. The inevitable result — a decline in the international competitiveness of South Korea's labor-intensive industries — undercut the government's industrial policy with its emphasis on maintaining the cost edge of domestically made products in world markets. The rapid growth in domestic consumption — especially of cars and consumer electronics products like televisions, which, at least through 1991, were South Korea's major export items — also raised questions among South Korean government officials and businessmen alike about the wisdom of the country's export-oriented growth strategy. At the same time the interests of South Korean business leaders were changing, shifting from government protection and promotion of export-oriented industries to more freedom to

conduct business at home. Various analysts have suggested that the bid of Chung Ju Yung, the founder of the Hyundai conglomerate, in the presidential election to be held late this year represents the private sector's dissatisfaction with the government's top-down style of economic management.

Pressure from Washington also is forcing Seoul to reconsider its economic policies. Although the share of South Korea's worldwide exports going to the United States dropped to about 25 percent in 1991 from 40 percent just five years earlier, this country still is the biggest foreign customer for Korean-made products. The majority of South Korea's U.S.-bound shipments consist of labor-intensive manufactures, such as electronic products, textiles and footwear, but over the last decade or so exports of steel, cars and other high value-added products have expanded rapidly. South Korean purchases from the United States are made up mainly of agricultural commodities, chemicals and machinery.

Until 1982 South Korea-U.S. trade was almost in balance. Starting the following year, however, South Korean exports to this country began climbing, while purchases of American-supplied goods remained relatively flat. By 1987 South Korea was running a \$9.6 billion surplus in trade with the United States. The fast-expanding bilateral surplus contributed to an improvement in South Korea's overall trade account, which had been in the red until 1985 but was \$10 billion in the black in 1988.

The surge in South Korean exports to the United States triggered several predictable responses from this country. Over the past decade, for example, a series of antidumping cases initiated by American manufacturers confronted with the market inroads of their South Korean competitors has resulted in penalty duties on various Korean exports, like color television sets, small business telephone systems, sweaters and photo albums. Major South Korean exporters also have been targets of industry-propelled U.S. drives for voluntary restraint agreements, orderly marketing agreements or other limits on competition from made-in-South-Korea products, starting with textiles and apparel in 1965 and including steel (1984) and machine tools (1986). Moreover, Washington "graduated" South Korea in 1989 from eligibility for duty-free tariff treatment under the Generalized System of Preferences.

While continuing to protect U.S. trade interests at home, the Bush administration has put increasing emphasis on expanded market opportunities in South Korea for American exporters of goods and services. Capitalizing on Seoul's worries that South Korea would be named a priority country for market access negotiations under the Super 301 provision of the 1988 Omnibus Trade and Competitiveness Act, U.S. trade negotiators won concessions in the spring of 1989 on a long list of goods of export interest to American companies. Seoul agreed to remove the quantitative import restrictions on 243 agricultural commodities and 30 manufactured products by July 1991. The government also promised to reduce the average tariff on farm goods to 7.9 percent in 1994 from the 1989 average of 12.7 percent and to trim the duties on manufactures from 11.2 percent on average to 6.2 percent over the same period.

As part of the negotiations that kept South Korea off the 1989 Super 301 list, Seoul agreed to modify its Foreign Capital Inducement Act in 1991 to reduce the restrictions on inward foreign investment. Requirements covering local content, technology transfers and local equity participation, among others, were lifted or modified. As of this year, for example, foreign investors can own up to 10 percent of the shares in a publicly traded South Korean company. In 1989 as well the South Korean government said it would strengthen enforcement of intellectual property protection, which Washington had cited as an area of concern when it placed South Korea on the priority watch list under the Special 301 provision of the 1988 trade act.

Since 1988 South Korea-U.S. trade has moved dramatically toward a balance. According to the statistics compiled by Seoul, South Korea had a \$300 million or so trade deficit with the United States in 1991. (Department of Commerce figures indicated, however, that this country ran a \$1.5

billion deficit in bilateral trade last year, although that number was far below the \$8.9 billion gap between exports and imports posted in both 1987 and 1988.) South Korea's imports of U.S. goods more than doubled between 1987 and 1991, while its exports to this country remained between \$18 billion and \$20 billion a year.

Although the market opening steps taken by Seoul and the trade-restrictive actions implemented by Washington contributed to the reduction in the South Korea-U.S. trade imbalance, most economists give primary credit for the reduced surplus to the post-1985 appreciation of the Korean won against the dollar. From an average of 870.02 won=\$1.00 in 1985 the value of the South Korean currency rose to 671.46 won to the dollar in 1989, a 29.6 percent realignment, before retreating to 733.35 won=\$1.00 in 1991. A number of analysts have suggested as well that the stumbling performance of the U.S. economy and South Korea's continuing economic boom have had an impact on transpacific trade flows. Whatever the ranking of these factors, the reduction in South Korea's trade surplus with the United States played a part in the return of red ink to that country's overall trade account in 1990. Last year South Korea's worldwide trade deficit totaled \$9.7 billion.

### Japan-South Korea Trade and Investment Relations

No small part of that imbalance was related to South Korea's trade with Japan. According to Japanese statistics, Japan's perennial trade surplus with its neighbor hit a record \$7.7 billion in 1991, more than double the recent low of \$3.6 billion registered in both 1988 and 1989. Many economists have pointed out that the chronic bilateral trade imbalance stems from South Korea's heavy dependence on Japanese suppliers for parts and components. Equally important, they say, are the difficulties that South Korean manufacturers have in selling in Japan, especially where there is strong domestic competition.

Japan has been South Korea's leading supplier of both machinery and parts since the two countries established diplomatic relations in 1965. The priority that Seoul's economic development game plan put on fostering consumer goods industries resulted in South Korean manufacturers turning to Japanese suppliers for machine tools and other production equipment as well as components and parts. As South Korea's export drive geared up in the 1980s, purchases of Japanese-made machinery and parts increased almost in tandem. While the share of textiles and apparel, chemicals, and metals and fabricated metal products in Japan's exports to South Korea decreased gradually during that decade as South Korean industry became competitive in these product areas, the relative importance of capital goods increased. Last year capital goods made up roughly 60 percent of Japan's South Korea-bound shipments (see Table 2).

Even though Japan consistently sells more to South Korea than it buys, Japanese exporters have market access complaints of their own. Automotive and consumer electronics products, Japan's top overall exports, have made only limited inroads in the South Korean market. This is due mostly to import restrictions. As part of its strategy to protect domestic makers of motor vehicles, consumer electronics goods and some other products, Seoul has required since 1980 that exporters in the country with which South Korea has recorded the largest bilateral trade deficit over a certain period get special permission to ship in about 250 items. The stated goal of this program is to help diversify South Korea's sources of supply. Initially, the prior year's trade data were used to determine which country's exporters won the dubious distinction of being subjected to this treatment. Japan was so identified between 1980 and 1982. However, in 1983 after South Korea reviewed the previous year's largest bilateral trade deficit, which was with Saudi Arabia, the rules suddenly were changed. Under the new regulations, which base each year's determination of the affected country on the previous five years of trade figures, Japanese suppliers have continued to be targeted for import restrictions. A report on foreign unfair trade policies and practices issued in June by MITI's Industrial Structure Council suggested that Seoul's country-targeted import restrictions violate the antidiscrimination rules of the General Agreement on Tariffs and Trade (see JEI Report No. 23B, June 19, 1992).

Table 2: Composition of Japan's Exports to South Korea, 1976-91

(share of total exports)

|                                        | 1976    | 1981    | 1986     | 1991     |
|----------------------------------------|---------|---------|----------|----------|
| Food                                   | 0.1%    | 6.0%*   | 0.1%     | 0.5%     |
| Textiles and Apparel                   | 10.8    | 6.2     | 5.0      | 3.6      |
| Chemicals                              | 18.1    | 14.8    | 13.2     | 13.0     |
| Nonmetallic Mineral Products           | 1.0     | 1.9     | 2.2      | 2.0      |
| Metals and Fabricated Metal Products   | 19.5    | 17.6    | 13.5     | 11.4     |
| Machinery and Transport Equipment      | 37.6    | 40.6    | 57.8     | 60.5     |
| Nonelectric Power Generating Machinery | 1.6     | 2.9     | 2.1      | 2.1      |
| Computers and Other Office Machines    | 0.6     | 0.8     | 4.1      | 2.8      |
| Metalworking Machinery                 | 2.8     | 1.3     | 3.9      | 4.3      |
| Textile Machinery                      | 4.1     | 2.3     | 1.6      | 2.7      |
| Electric Power Generating Machinery    | 1.5     | 2.4     | 2.9      | 2.1      |
| Electronic Tubes and Semiconductors    | 2.8     | 4.6     | 7.3      | 8.7      |
| Television Sets and Radio Receivers    | 1.0     | 0.4     | 0.3      | 0.2      |
| Videocassette and Tape Recorders       | 0.5     | 0.5     | 0.7      | 0.3      |
| Scientific and Medical Equipment       | 1.4     | 1.7     | 2.0      | 2.7      |
| Motor Vehicles                         | 0.3     | 0.5     | 0.2      | 0.6      |
| Other                                  | 12.8    | 12.7    | 8.3      | 9.0      |
| Total                                  | 100.0   | 100.0   | 100.0    | 100.0    |
| Total Exports (in millions of dollars) | \$2,824 | \$5,658 | \$10,475 | \$20,068 |

\*Includes rice shipped as food aid.

Source: Japan Tariff Association

Although South Korean products do not encounter similar trade barriers in Japan, South Korea's exporters complain about the problems of selling there. Most of the products exported by South Korean industry compete with made-in-Japan products, and that has limited their penetration of the Japanese market. Textiles and clothing, especially low-cost goods, have won relatively large shares of the Japanese market. Japan's imports of steel from South Korea, particularly commodity products in which Japanese mills are at an increasing cost disadvantage, also have expanded rapidly (see Table 3), but Japanese manufacturers generally have reacted warily to stepped-up competition from South Korean rivals. Japanese knitwear makers, for example, asked Tokyo in 1988 to negotiate a VRA with Seoul limiting shipments over the 1989-91 period (see *JEI Report* No. 26A, July 7, 1989). Moreover, South Korean government officials and businessmen often have complained about the comparatively high tariffs and/or nontariff barriers affecting imports of textiles, leather, footwear, toys, agricultural commodities and fish products from their country.

As indicated above, however, the frustrations are not one-sided. Moreover, they encompass not only Seoul's trade policies but also its continuing restrictions on foreign direct investment, particularly in the manufacturing sector. Reflecting the protectionism in this area, Japan's direct investment in South Korea is relatively small compared with the amount of money Japanese investors have put into other Asian countries. As of March 1992 Japan's cumulative direct investment in South Korea amounted to \$4.4 billion, well below the comparable totals for Indonesia (\$12.7 billion), Hong Kong (\$10.8 billion), Singapore (\$7.2 billion) and Thailand (\$5.2 billion).

Table 3: Composition of Japan's Imports from South Korea, 1976-91

(share of total imports)

|                                        | <u>1976</u> | <u>1981</u> | <u>1986</u> | <u>1991</u> |
|----------------------------------------|-------------|-------------|-------------|-------------|
| Food                                   | 23.2%       | 19.8%       | 21.8%       | 12.5%       |
| Textile Fibers                         | 1.3         | 0.2         | 0.2         | 0.1         |
| Metal Ores and Scrap                   | 1.2         | 0.4         | 0.2         | 0.2         |
| Other Raw Materials                    | 4.6         | 2.7         | 2.8         | 2.0         |
| Mineral Fuels                          | 3.9         | 2.8         | 5.6         | 4.2         |
| Chemicals                              | 2.8         | 7.8         | 6.1         | 5.0         |
| Textiles and Apparel                   | 35.5        | 30.2        | 24.4        | 23.7        |
| Steel                                  | 1.0         | 11.3        | 9.5         | 13.3        |
| Nonferrous Metals                      | 0.4         | 0.6         | 0.5         | 0.6         |
| Machinery and Transport Equipment      | 13.5        | 11.2        | 12.6        | 18.5        |
| Toys and Games                         | 0.2         | 0.2         | 0.6         | 0.9         |
| Other                                  | 12.4        | 12.7        | 15.7        | 19.0        |
| Total                                  | 100.0       | 100.0       | 100.0       | 100.0       |
| Total Imports (in millions of dollars) | \$1,917     | \$3,389     | \$5,292     | \$12,339    |

Source: Japan Tariff Association

### Bilateral Trade Talks

Criticism in South Korea of its year-in and year-out trade deficit with Japan was relatively mild during the late 1980s when the country had a surplus in its overall trade account. That has changed in the 1990s. Whenever government-level or private-sector talks are held, the main topic of discussion regardless of its position on the agenda inevitably is the bilateral trade imbalance. The January 1992 summit meeting of Prime Minister Kiichi Miyazawa and President Roh in Seoul was no exception. Although a variety of political and economic matters surfaced, the chronic South Korea-Japan trade gap dominated the talks (see *JEI Report* No. 3B, January 24, 1992). This issue had become even more critical from the host nation's perspective because South Korea's trade deficit with Japan had widened in 1991 despite a promise by Mr. Miyazawa's predecessor, Toshiki Kaifu, during his 1990 visit to Seoul to devise measures to narrow the bilateral trade imbalance.

South Korean participants in the talks left no doubt about which country's policies and practices they thought were responsible for the expanding bilateral trade imbalance. The Roh delegation characterized as reasonable its request for action by the Japanese government on tariffs, nontariff trade barriers and structural impediments to expanded sales of South Korean products in Japan, arguing that Tokyo should be as responsive to calls for improved market access from Japan's number-two trading partner as it had been in dealing with similar demands from the United States. The South Korean side also left no doubt that it expected Tokyo to persuade the Japanese business community to help expand imports from South Korea — for example, by asking trading houses and big manufacturing companies to draft plans to increase purchases of Korean-made products.

Japanese officials attending the Miyazawa-Roh meeting reacted coolly to Seoul's call for action. In stressing that many of the problems identified by South Korea had to be resolved by the private sector, the Japanese participants appeared to dismiss the idea of the government pushing companies to come up with plans to buy more South Korean goods. Japanese officials' response reflected the view in Japan's business community that Seoul's proposal was unwarranted since Japanese exporters' access to the South Korean market is restricted. At the same time, though, the

Japanese side promised to support expanded business transactions through the joint trade promotion activities of JETRO and the Korea Trade Association. Seoul also made no headway on its request for lower duties on 16 goods of particular interest to South Korean exporters, with the Miyazawa administration indicating that no duty cuts would be implemented pending conclusion of the Uruguay Round of multilateral trade negotiations.

Seoul also received little positive feedback on another issue high on its agenda for the Miyazawa-Roh talks — the transfer of advanced Japanese technologies. The South Korean government regards help of this type as a long-term solution to the bilateral-trade imbalance since access to sophisticated Japanese product and process know-how would improve the competitiveness of Korean products in Japan and reduce South Korean industry's heavy dependence on Japanese suppliers of capital equipment, such as machine tools. Technology transfer, however, is a difficult issue for Tokyo since most of the know-how that South Korean manufacturers want belongs to Japanese companies. Japan concluded 1,829 technology licensing deals with South Korea from 1985 to 1990 (see Table 4). Although that number represented almost half of the technology transfers from all countries to South Korea, the royalties and other fees received by Japan equaled just 31 percent of what South Korea paid out in total. Referring to that fact, South Korean government officials and businessmen often have complained that Japanese companies are willing to license only older-generation technology.

Table 4: International Technology Transfers to South Korea, 1985-90

(in millions of dollars and number of cases)

| Source        |       | 1985  | 1986  | 1987  | 1988  | 1989  | 1990    | Total<br>1985-90 |
|---------------|-------|-------|-------|-------|-------|-------|---------|------------------|
| Total         | Value | \$296 | \$411 | \$523 | \$676 | \$930 | \$1,087 | \$3,923          |
|               | Cases | 454   | 517   | 637   | 751   | 763   | 738     | 3,860            |
| Japan         | Value | \$75  | \$130 | \$181 | \$215 | \$274 | \$341   | \$1,216          |
|               | Cases | 228   | 264   | 307   | 354   | 343   | 333     | 1,829            |
| United States | Value | \$155 | \$192 | \$240 | \$330 | \$416 | \$514   | \$1,847          |
|               | Cases | 114   | 157   | 180   | 200   | 244   | 221     | 1,116            |
| West Germany  | Value | \$12  | \$19  | \$19  | \$22  | \$53  | \$59    | \$184            |
|               | Cases | 29    | 23    | 34    | 49    | 37    | 55      | 227              |

Source: Republic of Korea, Ministry of Finance

To facilitate technology transfers from Japan to South Korea President Roh proposed at his January meeting with Prime Minister Miyazawa that a foundation be set up for this specific purpose. That organization would collect data on which companies in Japan had technologies appropriate to South Korea's requirements and then make this information available to South Korean companies. If necessary, the foundation would provide financial help to South Korean firms to acquire Japanese technology. Of the estimated \$200 million needed to establish the foundation, Seoul suggested that the Japanese side fund 75 percent.

The Japanese delegation reportedly not only ruled out government funding for the proposed institute, arguing in part that South Korea no longer qualifies for foreign aid, but also said the technology transfer issue, in principle, should be handled by the two countries' business communities. Leading Japanese corporate executives agree that the decision to transfer technology, particularly the sophisticated know-how sought by South Korean competitors, should be based on commercial factors

rather than political considerations. They contend, however, that inadequate South Korean protection of Japanese intellectual property rights, including patent claims, is a major disincentive to licensing the cutting-edge know-how sought by companies in South Korea. While Seoul has allowed American and European companies to apply for patents on products as well as processes since 1987 and 1991, respectively, Japanese manufacturers still are limited to process patents.

Despite the multiple reservations of Japanese government officials and business leaders about Seoul's proposals for action on the trade and technology transfer fronts, Prime Minister Miyazawa agreed during his January talks with President Roh that the two countries would develop a package of measures by the end of June. Those initiatives were released June 30 by each country's foreign ministry. The most concrete part of the program is a plan for each country's private sector to set up a separate foundation capitalized at ¥1 billion (\$7.4 million at ¥135=\$1.00) to facilitate technology transfers. The specific activities of the planned institutes were not identified, but they are expected to undertake such projects as organizing information-gathering missions and exchanging trainees; these activities reportedly will be subsidized in part by Tokyo and Seoul. The two governments agreed as well to initiate talks in July on stronger South Korean protection of Japanese intellectual property rights. Ministry of Foreign Affairs officials say they hope these discussions can be wrapped up by the end of the year. Tokyo also noted in the package the possibilities for South Korean participation in government-sponsored international research and development projects, such as the Intelligent Manufacturing System and the Human Frontier Science Program (see *JEI Report No. 36A*, September 27, 1991), indicating that this was another avenue for technology transfer.

The action plan is short on trade-specific steps. One of the few is the creation of a new forum to enable Japanese and South Korean business leaders to discuss a variety of trade problems. Seoul also said it would allow Japanese trading companies to deal directly with South Korean customers and to handle overseas trade of Korean-made products to Japan or third countries, thereby addressing one long-standing Japanese complaint about restrictions on business activities in that country.

### **Bridging the Perception Gap Affecting Japan-South Korea Relations**

Recent talks between Tokyo and Seoul have highlighted the perception gap that divides the two countries, a divergence that mostly stems from historical rivalry and a complicated political history. Going far back in time, either the Japanese or the Koreans have assumed a superiority over their neighbors. More recently Japanese have tended to claim that their country's economic success induced South Korea's economic development. By copying the Japanese style of capitalism, South Korea had a relatively easy time catching up with developed economies, this argument goes.

South Koreans, on the contrary, suggest that Japan's economic success has been achieved at the expense of the Korean people. They say Koreans were sacrificed for Japan not only during that country's 1910-45 occupation of their homeland but even after World War II. The Korean War, for example, stimulated demand for Japanese-made products, thereby helping to accelerate Japan's economic development. Moreover, it is argued, while South Korea continued to be on the front line against the expansion of Communist powers and spent considerable amounts of money on defense — a benefit to countries like Japan, Japan earmarked most of its financial resources for economic development and spent little on security. For these reasons South Koreans feel justified in asking Japan to take responsibility for the bilateral trade imbalance, viewing it as compensation for past experiences and more recent "debts."

The memories and the after-effects of Japan's occupation of the Korean peninsula still impede confidence building on both sides. Although the 1965 Treaty on Basic Relations resolved the issue of compensation at the government level for Japan's occupation, many Koreans do not consider that Japan has made up fully for its past transgressions. In the last five years alone many issues related to the Japanese occupation have been raised by the South Korean government, including: Tokyo's

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requirement that Korean residents in Japan, including those born from conscripts brought to Japan before and during World War II, be fingerprinted; compensation for Koreans now living in their homeland who suffered from the atomic bombs dropped on Hiroshima and Nagasaki; the return of Korean cultural artifacts taken or bought by the Japanese during the occupation; assistance to reunify Korean families separated when some family members were forced to move by Japanese authorities to Sakhalin Island, which Japan ruled before the end of World War II; and compensation for "comfort ladies" — Korean and other women whom the Japanese military put in brothels to serve as prostitutes for Japanese soldiers (see *JEI Report* No. 2B, January 18, 1991, and No. 3B, January 24, 1992). Moreover, the surprise visit to North Korea in 1990 by Shin Kanemaru, an influential member of Japan's ruling party, upset Seoul (see *JEI Report* No. 40B, October 19, 1990). Many South Koreans also suspect that Tokyo's enactment of a measure that allows its Self-Defense Forces to participate in international peacekeeping operations sponsored by the United Nations might lead to renewed militarism in Japan.

Political issues like these have a way of complicating economic negotiations. Many analysts point to the precedent for linking politics with economics by citing Prime Minister Nakasone's 1983 decision to make loans on concessional terms available to South Korea, even though that country was on the verge of moving out of the developing-nation category. Yet, without resolving the political problems, the trade and other economic problems straining the Japan-South Korea relationship will be difficult to rectify. Political issues often seem to be raised by both countries when economic relations worsen. Since the Asian Pacific region is expected to be a growth center for the world economy into the next century, addressing bilateral political and economic problems would benefit the region as well as both Japan and South Korea. The frank discussions involved in drafting the action program may contribute to increased recognition of the other party's concerns. That may prove to be an essential first step in airing the differences in perception that pose fundamental barriers to improved overall Japan-South Korea relations.

For further information, contact Tadashi Saito.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.